R410C-90

The Conference Board

Volume 1, Number 5 October 1990

Economic Times

INSIDE:

- **New Industry Outlook Report** *(center section)*
- **Colloquium on New Auto Mileage Requirements** *(page 3)*
- **The Economics of War** *(pages 4-5)*
- **Power to the People** *(page 6)*
- **The Crystal Ball** *(page 11)*

Editor's Note

This month we introduce a new feature I'm sure you'll like: an *Industry Outlook Report* (You'll find it on the shaded paper in the middle of this issue.) It includes brief analyses prepared by highly qualified industry analysts on the current outlook for seven different industries. In the future we will include these reports in the first month of each quarter, rotating among a total of about 20 different industries.

The common denominator of the other articles this month is unconventionality. First, you'll find Carl Kaysen's fascinating ideas on the probability of major wars — a very out-of-the-ordinary application of economic principles. Kaysen is followed by Ben Stein's revealing look at how dramatically everyday life has changed over the centuries. Finally, we offer a couple of the strong-minded and perhaps somewhat contentious views of Thomas Sowell. Enjoy!

Maxim of the month:

Ask five economists and you'll get five opinions — six if one went to Harvard.

How to Clean More Windshields

The big jump in gasoline and fuel-oil prices brought on by the Middle East crisis has — understandably — angered consumers and — predictably — evoked shrill complaints from politicians and self-appointed consumer advocates. The shrillest have been directed at "Big Oil." Michigan's Governor Blanchard, for example, said the price increases "reflect the stranglehold major oil companies have on the oil industry," and he introduced legislation "to break up the oil monopolies." A Minnesotan referred to "the thieves in the corporate board rooms of the oil companies." (Isn't it curious how the usually conservative Upper Midwest so often produces the most rabid anti-big-business populists!)

Concern about monopoly is nothing new in this country, of course. Indeed, in the case of petroleum, it was fully justified early in this century before the Standard Oil trust was broken up. But since World War II, despite occasional attention in Congress, interest in the monopoly issue has gradually faded. Why? Simple! Competition keeps breaking out, both domestically and, importantly, from foreign producers.

Well, whom should be blamed for the rise in petroleum prices? The fact that war threatens to engulf the world's major oil exporters would seem to most people to be an adequate explanation. But it's not enough for some who, evidently, need to identify a scapegoat closer to home. Usually it's Big Oil but sometimes it's the local service-station operator.

Is there greed in the plush corporate offices of giant oil companies? Yes, I'm sure there is. How about the grimy repair bays of neighborhood gas stations? Yes, greed is found there, too. Were some petroleum prices raised in advance of cost increases? Yes, surely. Justifiably? Maybe, maybe not. But the issue is really not worth arguing; it's just not all that important. First, greed is not an exclusive characteristic of people in the oil business; it's universal. Why, you will even find it in the halls of Congress and in the hearts of "public-interest" activists — although the goal there may be media attention and power more than money. Greed is as American as apple pie. Second, we shouldn't let ourselves get so worked up about gasoline prices going up sooner or farther than the accompanying costs, because these things almost always sort themselves out before too long. Competition does function the way it's supposed to — not instantaneously, not perfectly, but pretty well.

How do we know? Mostly we know because of the relatively bad performance of alternative approaches, centralized control of the economy and regulated industries. Competitive markets operate more efficiently and produce higher standards of living. We also can tell that competition works by looking at the record of industry profits. Longer term, the rate of return on invested capital averages about the same in all industries. If the oil industry and others are monopolies, where are the monopoly profits?

Years ago, after one of the oil crises of the 1970s had passed, CBS news reporter Harry Reasoner commented on how he was treated when he bought gas, contrasting the period of shortages and controlled prices against the later period of normal competition. He noted that the attendants were again washing windshields, and concluded that, "Competition cleans more windshields." Right you are, Harry!

Ed Fiedler

Copyright 1990 by The Conference Board.
Economic Times (ISSN 1050-0200) is published 10 times annually (July/August and November/December are combined issues) by The Conference Board, Inc., 845 Third Avenue, New York, N.Y. 10022-6601. Printed in Alpha, New Jersey. Second-class postage paid at New York, N.Y. and other mailing offices. POSTMASTER: Send address changes to Economic Times, 845 Third Avenue, New York, N.Y. 10022-6601. Editor: Edgar R. Fiedler

The Conference Board, 845 Third Avenue, New York, New York, 10022
The Conference Board Europe, Avenue Louise, 207 - Bte 5, B-1050 Brussels, Belgium
The Conference Board of Canada, 255 Smyth Road, Ottawa, Ontario, KIH-8M7

Colloquium

Background:

The Middle East crisis, by reminding us how dependent we are for oil from an unstable part of the world, has focused new attention on mandated fuel-efficiency standards for the automobile manufacturers. Considerable support has recently been expressed in Congress for legislation that over the next decade would require each automaker to increase the average fuel economy of its fleet by some 40 percent, to 40 miles per gallon from the present level of about 27 1/2.

Question:

Do you regard this approach — a mandated mileage bill — as a good way to reduce our dependence on imported energy?

Don Conlan
Capital Strategy Research

Why not mandate morality, too! More wrong-end economics. Want to achieve 40 miles per gallon efficiently? Put a sizable tax on gasoline. Regressive? You bet! So is everything else they do down there these days. Maybe add a gas-guzzler tax that really bites. And how about this as a kicker: For every mpg the auto makers must raise the standards, Congress must cut the budget deficit by a no-nonsense $10 billion. Monkey dictate, monkey do!

Charles L. Schultze
The Brookings Institution

The most effective way to prepare for a surge in oil prices is to build up a truly sizable stock pile of crude oil — and be willing to use it. If in addition we want to enforce more energy conservation, then a gasoline tax is a far better way to reduce consumption than mandated mileage standards for auto manufacturers — as is amply documented in a Brookings' study by Robert Crandall and others.

Andrew Brimmer
Brimmer & Company

American automakers should *not* be mandated to increase fleet average fuel economy to 40 miles per gallon. Even with the best engine technology, this would probably require that virtually all new cars be subcompacts. By trading off some pollution abatement equipment to reduce weight, producers probably could stretch average mileage to about 32 miles per gallon. Meanwhile, oil supply should be increased by expanded drilling in a number of offshore and Alaskan areas where it is presently prohibited.

Isabel Sawhill
The Urban Institute

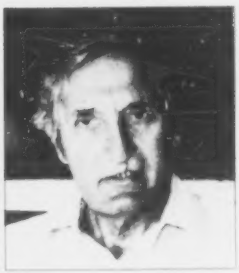
More stringent fuel economy standards are a bad idea. They lead to inefficient decisions by automakers and increase the cost of new cars, causing consumers to drive their old gas-guzzlers longer. A better way to encourage conservation is to increase gasoline taxes. If we had done so a few years ago we wouldn't be in such duck soup now. The deficit, emissions of greenhouse gases, and dependence on foreign oil would all be lower.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charls E. Walker, Chairman, Charls E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

Is War Obsolete?

By Carl Kaysen



Wars of the kind under consideration have become unthinkable because they have become economically and politically unprofitable.

In the nineteenth century, economy, polity, society, and culture were all transformed in ways that fundamentally changed the calculus of war.

The forty-five years that have now passed since the end of World War II without interstate war in Europe is the longest such period in its post-medieval history. Many scholars and commentators have attributed the present "long peace" among the major powers to the deterrent effect of nuclear weapons. John Mueller's *Retreat from Doomsday* (New York, Basic Books, 1989) advances a much stronger thesis: major war was already becoming obsolete by the time of the First World War; World War II repeated and reinforced that lesson. The development of nuclear weapons was accordingly irrelevant to the process.

The burden of this essay is that wars of the kind under consideration have become unthinkable because they have become economically and politically unprofitable. Further, Mueller is too cavalier in his dismissal of the significance of nuclear weapons.

The Historical Background

Understanding why war has become obsolescent requires an examination of the political and economic calculus of war. In the starkest and simplest terms, the key proposition is that for most of human history, societies were so organized that war could be profitable for the victors, in both economic and political terms. But profound changes in economics and politics in the last century and a half, following the Industrial Revolution, have changed the terms of the calculation.

For millennia, societies were organized around landholding as the chief basis of both economic and political power. In such societies, successful war yielded a clear gain: control over territory — additional land and the associated labor force — that added directly to both economic and political power. Compared to the potential returns, costs, at least for the winner, were small.

In the political structure characteristic of these societies, the power holders were themselves the warriors, and the connection between those who fought wars and those who, in victory, gained from them was direct and immediate. Conversely, the large mass of the population was separated entirely from political power and almost entirely from war.

This is, of course, a highly schematic account, but as a set of stylized facts, it serves well to characterize most of Europe from the ninth to the fifteenth centuries. By the end of the fifteenth century, the scheme needs enlargement. Nonetheless, over the next three centuries the political, economic, and technical parameters remained such that war could still be seen as an enterprise in which possible gains outweighed costs.

Does War Still Pay? The Economic and Political Calculus

In the nineteenth century, economy, polity, society, and culture were all transformed in ways that fundamentally changed the calculus of war. By the end of the century, urban outweighed rural populations in half of Europe and, by the middle of the next, in most of the rest of Europe and North America, too. War, too, was industrialized: more powerful weapons, larger and more complexly organized armies, and great improvements in supply, transport, and communication changed its scale and intensity. After the American and French Revolutions, the fundamental basis of political legitimacy changed. More and more of the population were included in the politically significant classes.

All of these nineteenth-century changes affected both the potential gains and the potential costs of war. In the

economic sphere, land greatly diminished in importance as a resource. Industrialization multiplied both the scale and cost of war; industrial wars involved the whole nation, not the typically small fraction of population and output drawn into earlier wars. World Wars I and II far outweighed anything that had gone before in destructiveness.

On the other side of the ledger, the extent to which the conquest of new territory added to the economic strength of the conqueror is questionable. The question is whether the economy of a different society, all or part of another industrial nation, can be effectively incorporated by conquest against the will of its inhabitants.

Even authoritarian and repressive governments in modern societies need the consent, however tacit and grudging, of the mass of the governed.

In politics, too, the last century-and-a-half has brought a profound transformation. Governments have become popular and populist even when not democratic; the welfare of the general population, conceived in a broad sense, is their chief business, and it is to achieving this that they bend their efforts. And even authoritarian and repressive governments in modern societies need the consent, however tacit and grudging, of the mass of the governed. Economic well-being and social peace are the chief elements on which this consent rests.

Making war can rarely contribute positively to these goals. In the short run, the mass of the public bears heavy costs. Peace, not war, is seen as the natural state of affairs by leaders as well as the public. Further, the dominance of the nation-state as a focus of popular sentiment has delegitimated wars of conquest; they are not only unlikely to be profitable, they are viewed as wrong.

Although the cultural transformation is far from complete, the changes in society, economy, and polity sketched in the preceding paragraphs provide both the context for and a substantial part of the explanation for the obsolescence of major war in the industrialized world.

The argument so far has made no mention of the nuclear revolution, and so far is in accord with Mueller's contention that major war between modern nations was on its way to obsolescence before the development of nuclear weapons. However, this is not to accept that the profound revolution in the technology of war brought by nuclear and thermonuclear weapons and long-range ballistic missiles does not matter; quite the contrary. These new technologies of war have amplified the message of this century's war experiences by many decibels, and set it firmly in the minds of the wide public as well as those of political and military leaders.

Concluding Observations

If wars among modern nations truly serve no possible rational purpose, why is there no wide, even universal, recognition of this proposition? The general answer is that cultures change much more slowly than technologies and institutions. As Keynes said, most living politicians are slaves of some dead scribbler.

For most government and political elites in modern states, the old ideas of military power and "defense" as the core of national sovereignty still carry great weight. Accordingly, providing the capability for war, and being in some sense prepared to use it, still command a large share of the resources and energies of governments.

On a more concrete level, the powerful grip of ideology on governments and publics on both sides of the great postwar East-West divide has diverted attention from the changes sketched above. But the revolutionary change in military technology, especially in the last twenty-five years, has loosened the grip of ideology on both sides of the divide. The self-confessed failure of Communist ideology as a blueprint for successful social organization is helping to complete the process, and opening the way to new thinking in the West as well as the East.

Why is there no wide recognition of this proposition? The general answer is that cultures change much more slowly than technologies and institutions.

Assuming that the foregoing analysis is correct, and assuming further that it can be made widely persuasive, does not imply that the world is on the threshold of universal and perpetual peace. Fully modern industrial nations are still in the minority in the world in both number and population. Civil wars, and forms of violent international conflict falling short of war, are widespread and will continue to be so in the foreseeable future. Nonetheless, this analysis offers a real basis for hope.

These excerpts represent the essence of a much more complex argument published in *International Security*, Spring 1990. Carl Kasen is David W. Skinner Professor of Political Economy at the Massachusetts Institute of Technology.

Power to the People

By Benjamin J. Stein

While stuck in traffic on the Hollywood Freeway a while back, I had a thought:

It is a commonplace of pop-psychosociology to say that modern man has become insignificant. Because of mass production, industrialization, the mystery of science, the bigness of finance, the crowding of cities, and the disappearance of small-town life except as a curiosity, man today is supposed to have become small. This theory of the atomization of man in the industrial context has been memorialized by Karl Marx, Charles Reich, David Riesman and many others. It is a common political theme today, sounded to especially good advantage by Jesse Jackson during the 1988 campaign.

It is true that man can be made to feel insignificant by modern-day industrial society. Anyone who travels through any large city's airport in the summer, or tries to get an explanation of his health insurance coverage, or tries to find out anything about anything from the federal government, well knows the way an atom in a dead leaf in a forgotten field must feel.

But if that feeling is present from time to time, and it is, I respectfully suggest that life confers upon modern man a sense of power unimaginable in earlier eras. Take, for example, the automobile. Anyone who drives a car gets a feeling of power that John D. Rockefeller could only have dreamed of. Yet today it is available to the lowliest licensed sixteen year old.

Or take television: Any entry level clerk-typist can see a color picture, with sound, of creatures fighting in outer space, or the Old West, or live news coverage of a disaster in Dubai or Dallas, or the Cosby household. Not Caesar, not Napoleon, not Lenin or Hitler could wield such control over the fantasy process, which every gas station attendant now takes for granted.

"She shall have music wherever she goes," was once a part of a nursery rhyme invocation for children. The idea that anyone, even a king, could have music wherever he went would have seemed impossible, inconceivable, even for a Hapsburg or a Medici. Today, any child with about ten dollars can own a device that gives him an infinite variety of music wherever he walks or runs, played and replayed as faithfully as if he were in the Kennedy Center. The riches of Alexander the Great could not have begun to purchase such power.

Or, imagine the power of communications in today's world. Only one hundred years ago, when Americans or Hungarians lived in rural areas, their lives were genuinely and unalterably lonely. Read *Winesburg, Ohio* and just try to contemplate such isolation as those farmers and their wives and children put up with day after day.

But today, anyone, of almost any station in life, can pick up the telephone and talk to a friend at any point on the globe, something that was unheard of for the Sun King or for Darius of Persia. Yet any college student thinks it simply a basic part of life. That it exists today is the bestowal of mighty power indeed on those who have it — and that's almost everyone.

Or take travel. Yes, indeed, travel today is crowded, hot, and filled with inconsideration. But one hundred years ago, travel as is commonplace today simply did not exist. Coast-to-coast travel in America was a genuine hardship, a genuine struggle. America-to-Europe travel was lengthy, tiring, and available to only a tiny number of the affluent — except in steerage, which would make today's airline travel look luxurious.

For the ordinary worker to simply pick up and move himself to another continent for about a week's pay would have been inconceivable as a display of power as recently as fifty years ago, perhaps as recently as twenty years ago. Yet that power exists today and is so easily accessed that it would have made Charles Lindbergh's head spin.

Then there is computing power, available to a slightly smaller number, and access to information, also on a scale undreamed of even ten years ago. Anyone can get information from the greatest libraries in the world instantaneously. The merest tot can make calculations in seconds that would have taken the entire Royal Observatory a lifetime.

In a word, the notion that modern *homo sapiens* (although I'm beginning to wonder about the *sapiens* part) is powerless and weak in today's world, that he is an inconsequential nothing, is simply betrayed by facts. To paint modern man as powerless and deracinated is simply to ignore the power that society and that industry have conferred upon Everyman, more power than the Tsar knew existed.

At least it's something to think about when you're stuck in traffic.

Excerpted from *Public Opinion*, September/October 1988, published by the American Enterprise Institute. Benjamin J. Stein is author of *Hollywood Days, Hollywood Nights: Diary of a Mad Screenwriter*.

Industry Outlook Report

October 1990

Overview

Edgar R. Fiedler, The Conference Board

The outlook for most industries closely parallels the general economy: irresolute, trendless, and engulfed in a miasma of lethargy and foreboding. Signs of classic business-cycle downturn are few and far between. But there is foreboding, mostly arising from the Middle East crisis, which has consumers and investors confused, cautious and in the mood to postpone spending plans, perhaps enough to bring on recession.

Our panel of industry analysts confirms this uncertainty. Some, like those in retailing, capital equipment and business-support services, project sales still advancing, although not with any zip. The analysts for chemicals and capital equipment point to international demand as a bright spot, thanks to the strong competitive position afforded U.S. manufacturers by the lower exchange value of the dollar. Sales of cars and trucks are forecast to drop from 14.2 million units this year to 13.8 million in 1991.

The most pessimistic dimension in our industry reports is profits. The exception is apparel where earnings are expected to rise 13 percent this year and 21 percent in 1991. Elsewhere, profits are being squeezed, and dramatically so where oil is a major cost. In chemicals, operating income is expected to fall 25 percent this year and another 15 percent next year, with most of the decline in commodity chemicals. And the airlines are projected to see 1989's $1.4 billion of profits turn into a billion-dollar loss this year, enough to force the disappearance of several weaker carriers.

In sum, the industry outlook is a mixed bag of pluses and minuses. Attitudes, however, show no such balance; they are, rather, overwhelmingly unsettled and joyless. After eight years of fairly steady onward-and-upward performance, it's probably not surprising that the anxieties now outweigh the hopes.

Automobiles

Donald P. Hilty, Chrysler

Car and truck purchases postponed during the early 1980s recovered fully by mid-1989. Then the industry introduced innovative incentives to prop up unit sales. But profits deteriorated as firms began outbidding each other. The best we can expect are sales along their long-term trend: 14.8 million vehicles this year, 15.0 million next.

In the second half of 1989, the industry experienced roller coaster sales. During August and September, especially attractive incentives cleared leftover 1989 vehicles and propelled sales to expected peak annual rates. At 1990 model introduction, price increases and reduced incentives caused annual sales rates to drop to trough levels. This uncharted incentive environment and eroding consumer confidence have made customers, dealers, auto manufacturers, and suppliers skittish. Sales in 1990 have been erratic while averaging 14.4 million (annual rate) or about 2 1/2 percent below the long-term trend.

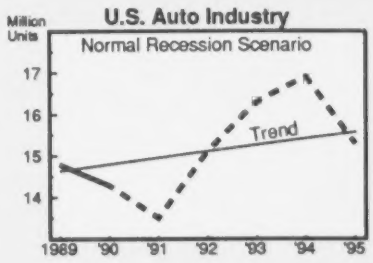
Outlook

August sales fell to a 13.9 million annual rate and probably will not increase for the rest of the year. For next year the industry could find itself on one of 3 sales paths: **(1)** Recovery nearly to trend if the Mideast crisis ends in a few months (25 percent probability), **(2)** Drop to 13.5 million in trough of a recession (60 percent probability), **(3)** Plunge toward 12.2 million if an oil shock occurs (15 percent probability).

During the past month, auto analysts generally have reduced forecasts by 100,000 to 200,000 units for 1990, and 500,000, for 1991.

The most likely path is for industry sales to average 14.2 million vehicles this year, 13.8 next. July inventories seemed healthy: 68 days supply versus normal 62. End of August stocks climbed to 70 days supply versus a normal 59.

Thus auto profits will be meager this year and next: near break-even from North American operations (slim for cars, better for trucks) and down somewhat from international operations.



Chemicals

A. Nicholas Filippello, Monsanto

As the economy flirts with recession and the impact of events in the Middle East begins to be felt, the U.S. chemical industry faces a challenging environment. Domestic demand is likely to parallel volumes in key end-use markets.

Any economic downturn will have a direct and immediate effect on demand from cyclical industries such as automotive vehicles, construction and consumer durable goods. Demand from less cyclical end-use markets, such as pharmaceuticals, food, soaps and personal products, should maintain some growth.

International demand will continue strong because of expected growth in Far Eastern and European markets, a weakened dollar and a U.S. comparative advantage in high value chemical products. The industry should continue to be among the best international trade performers with an annual trade surplus of $12-15 billion this year and next.

In recent months there have been selected increases in the prices of basic petrochemicals, owing to refinery accidents, weather damage and, more recently, to uncertainties in world petroleum markets. Nevertheless, there still exists a worldwide surplus of petrochemical production capacity. Planned capacity build-ups for commodity petrochemicals and plastics, particularly in Asia, will widen this gap over the next three years. Ultimately, economic forces will reassert a sustained decline in real petrochemical prices.

In the face of higher feedstock costs, commodity chemical profit margins will remain under pressure as excess capacity limits the degree to which costs can be passed on. Recent oil price increases will thus be felt more by producers of basic petrochemicals than by producers of downstream value-added products.

Additionally, in an economic downturn, specialty chemical producers would be affected less than commodity producers. Demand and pricing for specialty products are determined more by value created for downstream customers than by input costs or near-term supply-demand balances.

Longer term, the restructurings of major chemical companies during the 1980s will serve the industry well. The challenge still exists, however, to control costs, enhance productivity, reduce toxic emissions in a cost-effective manner, refine product portfolios and invent and develop the growth products of the 21st century for the world market.

Industry Sales & Profits

	1989	1990*e*	1991*e*
Sales	+7.5%	+2.5%	+1.0%
Oper. Inc.	-5.3%	-25.0%	-15.0%

Business Services

Joseph W. Duncan, Dun & Bradstreet

In the 1970's corporations attempted to organize, through vertical integration, all business services under their direct control. In the 1980's, with increasing cost pressure and more specified strategic focus, business services were moved outside the organization and into the services sector. Now as the 1990's start, business services are increasingly focused on providing highly productive, relevant input to their clients in other sectors.

Since government statistics have failed to evolve as quickly as the sector of business services has evolved, not much data are available for this part of the economy. Employment data can be used as one indicator, however. In 1989, the business-services sector (defined by BLS) employed 5.8 million workers or 5.3 percent of the labor force, up from 3.4 percent in 1980, before the divestiture of these activities from larger corporations.

Business services is a very diverse sector. It can be divided into two broad categories: (1) business support, which includes advertising, credit-reporting, and computer and data-processing services and (2) infrastructure support, which includes mailing and reproduction services, temporary help and maintenance and custodial services to buildings. Infrastructure is about twice as large as the business-support segments.

This distinction is important. Employment growth in infrastructure services is highly cyclical and currently in the midst of a downturn that began in 1989. In contrast, employment in business-support services continues to be strong. While this sector is not immune to the business cycle, a case can be made that these essential functions increase in importance during times of economic stress, since they may increase productivity or revenues. For example, as business failures increase (they are currently up 12 percent over year-ago levels) credit ratings become increasingly important to companies who want to be certain that their bills will indeed be paid.

In conclusion, the business services sector is demonstrating some stress as the economy is slowing. However, some business services are essential, particularly in times of economic stress.

General Merchandise Retailing

Thomas Swanstrom, Sears, Roebuck

In an uncertain forecasting environment, we believe that general merchandise sales growth in 1991 will look a lot like 1990. Our forecast calls for a 4.6 percent gain in dollars, which would only be slightly lower than the 4.7 percent increase estimated for 1990. But the gain next year will consist of a little more inflation and less real growth than will be true for 1990. We expect general merchandise inflation to rise from a 2.7 percent rate in 1990 to 3.2 percent in 1991. Real growth thus would slip from 2.0 percent in 1990 to 1.4 percent in 1991.

In terms of merchandise categories, the best gains should be registered by computers and business equipment, paint and wallcoverings, women's apparel, lawn and garden supplies, floorcoverings, and children's apparel. Women's and children's apparel sales in particular are very resistant to a slow economy and both should do well. When apparel spending cutbacks are made, they normally appear first in the men's clothing area and rarely impede women's apparel sales.

Luggage, sporting goods, small appliances, furniture, hardware, and auto accessories are forecast to be relatively weak spending areas.

By region, the greatest weakness should again be felt in the Northeast with the Massachusetts, Connecticut, and New York markets being the most impacted. Pockets of regional strength should include Houston, Seattle, Puerto Rico, Portland (Oregon), Las Vegas and Northern California.

Retailers have been very conservative in buying for the Christmas season, often drastically shortening their ordering lead times. Industry inventories are thus now in very good shape. But, if Christmas business turns out to be better than expected, this posture could result in some last-minute scurrying to fill the merchandise pipelines.

Apparel

Edward F. Johnson, Prescott, Ball & Turben

Apparel manufacturers have faced an uphill battle over the years to increase sales and earnings and even to stay alive. Their biggest adversary has been imports, which have increased share of the consumer market to 42 percent for 1989 from 17 percent for 1973. Last year, imports were up 14 percent compared to a 4.7 percent increase (adjusted for inflation)in consumer expenditures on apparel. On top of this gradual erosion of the market for domestically manufactured apparel, there are periodic downswings in retail buyer demand for product due to excess inventories at retail stores. The ongoing consolidation of stores into larger companies has made for fewer individual retail companies and the necessity for larger apparel companies to supply their requirements. The recent bankruptcies and near bankruptcies of Ames, Allied, Federated, Macy, etc. have added another note of uncertainty for apparel managements.

These negatives have resulted through the years in the disappearance of such well-known companies as Bobbie Brooks, Kayser Roth, Villager, Jonathan Logan, etc. Also the recent merger and buy-out craze has resulted in the disappearance from the public market of such as Hanes, Cluett Peabody, Champion Products, Levi Strauss, etc. But all is not gloom and doom. Apparel companies are sourcing more products from the Caribbean, Pacific Basin, and other foreign countries. The current trend to "just in time" retail ordering to reduce inventory levels has favored domestic producers over long-lead-time imports. A number of companies are also fighting back by rapidly establishing dual distribution through chains of factory outlet stores.

The apparel industry has recently been on a roller coaster, however. The industry recession of 1987-1988 caused by high women's wear inflation (consumer prices for women's wear increased 6.2 percent in 1987), high retail inventories, and fashion confusion was replaced by a short industry upturn starting in the fall of 1988. This upturn came to a halt around September 1989 as high retail inventories (partly caused by overordering of private label imports) sharply reduced store buying. This downturn was made worse during the first seven months of 1990 by high women's wear inflation, again resulting in consumer spending on women's wear to be up a low 0.8 percent, compared to an increase of 5.1 percent for all of 1989. Retail ordering became more cautious following the Iraqi crisis with consumer spending on general merchandising slowing down starting in the third week of August.

But this poor environment is expected to be followed by an upturn in 1991. The Redbook index of apparel company earnings projects gains of 13 percent for 1990 and 21 percent for 1991, following a 17 percent increase for 1989.

Airlines

George W. James, Airline Economics, Inc.

The deregulated U.S. airline industry continues to move toward its instinctive objective: a few large carriers holding immense domestic and international route systems. Meanwhile, however, the several airlines destined to leave the system, e.g., Eastern, Pan Am and TWA, warp the normal pricing and profitability patterns as they make cash flow their top objective. More significantly, the Iraqi action in the Middle East has placed a potential fuel cost burden on the airline industry that not only alters the financial outlook from nominal profitability to possible record losses but also accelerates the demise of the several marginal carriers.

Airline Financial Performance

	1988	1989	1990
Revenues	+12%	+7%	+7%
Costs	+10%	+10%	+10%
Profit/Loss	$2.8 bil.	$1.4 bil	($1 bil)

From 1983 to 1988 airline profitability improved as mergers, acquisitions and bankruptcies occurred across the system. Those carriers with growing hub-spoke systems, computerized reservation systems, sophisticated pricing mechanisms, and expanding international route structures, crowded out other carriers and their profitability improved. Then the competition among the remaining nine large carriers intensified as the weaker ones struggling for survival resorted to severe price cutting for cash-flow purposes. Linked with a stagnant U.S. economy, this began a 1988 profitability decline that has continued into 1990.

Accelerating this adverse impact on the industry is the Iraqi fuel crisis which, with a possible crude oil price increase of $7/bbl. from $18 to $25, will raise U.S. airline jet fuel costs by $4 billion annually. A $1/bbl. increase in crude raises jet fuel 3-1/2c per gallon. Every 1c increase in jet fuel increases costs by $160 million.

With these cost increases ahead, the industry now must reverse its 1990 operating profit outlook from about $500 million to a possible record operating loss of $1 billion. That will force the disappearance of the more marginal carriers and, in the face of a flat economy and rising fuel costs, offer the possibility that 1991 will still show operating losses.

Then, beyond 1991, industry profitability will improve significantly as the remaining carriers, highly efficient and not faced with "fire sale" pricing, allow the industry to approach normal U.S. industry profit margins.

Capital Equipment

Adrian T. Dillon, Eaton Corporation

Short run, the major impact of the Persian Gulf crisis will be the heightened sense of uncertainty about the future that will make us postpone discretionary, big-ticket purchases like cars, homes, and "short-cycle" capital goods. That hesitation will, at a minimum, prolong the sluggishness in economic activity through year-end. But, unless the situation in the Middle East deteriorates sharply from here, we do not believe a U.S. recession is "inevitable:" The net impact of higher oil prices will be to delay – and dampen – the rebound in growth that we had expected during the second half of this year.

In view of this prolonged economic slowdown and the continuing pressure on operating profit margins, the stability of capital equipment spending to date is itself remarkable. The July-August capital spending survey, with its 5-percent inflation-adjusted rise in 1990 spending, illustrates the sustained commitment by U.S. businesses to reinforce their competitive positions for the brutal global competition of the 1990s. Among the major components, the strength this year has been in aircraft and information-processing equipment; trucks and industrial equipment have shown the most weakness.

A 5-percent increase in 1991 equipment spending is not as aggressive a forecast as it may seem to be. Information processing growth is expected to slow to less than 6-percent, the slowest pace in over a decade! Motor vehicle purchases, after a two year decline, are expected to rise modestly while higher aircraft deliveries will continue to boost total transportation-equipment purchases. Industrial-machinery purchases are expected to be up less than 2-percent. Thus, other than aircraft, there's no large area of strength; rather, it's the absence of new areas of weakness that in effect give a boost to overall spending. Assuming the overall economy grows 2-percent to 3-percent in 1992, equipment purchases should show more uniform strength, with total purchases up about 6-percent. Finally, with the dollar reaching new lows, the outlook for U.S. trade in capital goods keeps improving. U.S. capital-equipment producers should, therefore, do better than implied by the increase in domestic demand.

Quotable Quotes

Thomas Sowell on Politics

My political bias is that I'm biased against politics. I haven't been a member of any political party since 1972. And I am really quite disenchanted with politics of all sorts.

Why? Mainly just by following what they do and how they do it. They're really quite clever at the things they do, but the things they do really don't benefit the public very much.

If that's changed any over the years, it's been for the worse. But I see some hopeful signs: People are talking about limiting the terms of Congressmen. I would like to see them limited to one term. If, for example, you're going to allow a Representative to spend four years in the House, I would rather see that changed to one four-year term rather than two two-year terms, because the problem is re-election. As long as they have to be re-elected and have to raise all that money, then they're going to sell out the public interest to get the money. It's really quite simple.

For example, an industry like the sugar industry can contribute money to Congress and Congress will appropriate enough subsidies to the sugar industry to pay them back a thousand dollars on every dollar. There aren't many places you can get that kind of return on your investment. There is no sign that's going to stop--either that the industry is going to stop offering the money or that Congress is going to stop giving the subsidies.

And on Intellectuals

I'm thinking of writing a book about intellectuals. Yes, Paul Johnson just wrote one, but mine would not be as generous as his.

How should we define "intellectual"? I think of it as an occupational description. They're people who make their living with words. There's nothing qualitative about it. I will not assume, for example, that the average sociologist is smarter than the average auto repair man. So it's not an honorific term, it's simply a job description — the way you would describe an accountant or a policeman or any other job.

It's not that I don't like intellectuals; in fact I think they're funny in some ways. But intellectuals have a set of attitudes and beliefs that simply will not stand up under scrutiny, and which have been enormously damaging to society. Now if it was merely that they had a few crazy ideas of their own, which they kept among themselves, who would care? But many of these ideas — preferential policies, for example, and environmentalism — have sacrificed an enormous volume of resources, and thus reduced the well-being of other members of society. And all of that has been done just so a handful of people can feel especially noble and especially wise.

(Dr. Sowell, a Senior Fellow at the Hoover Institution, Stanford University, is the author of *Preferential Policies, An International Perspective*. The above is adapted from his remarks on "Booknotes," a C-SPAN television production recorded May 24, 1990.)

Deja Vu All Over Again

The defense industry boom is fading. After a full decade of rising military outlays, the Pentagon has started to slash procurement as well as hold the line on its research and development outlays…Warnings about the impact of defense procurement cutbacks have come in loud and strong from government officials and from witnesses before Congressional subcommittees…[A] Deputy Assistant Defense Secretary…chided defense contractors for not moving vigorously in planning for adjustment. He accused some of wistfully clinging to the status quo and told them there's good evidence that others are suffering from "hardening of the management arteries."

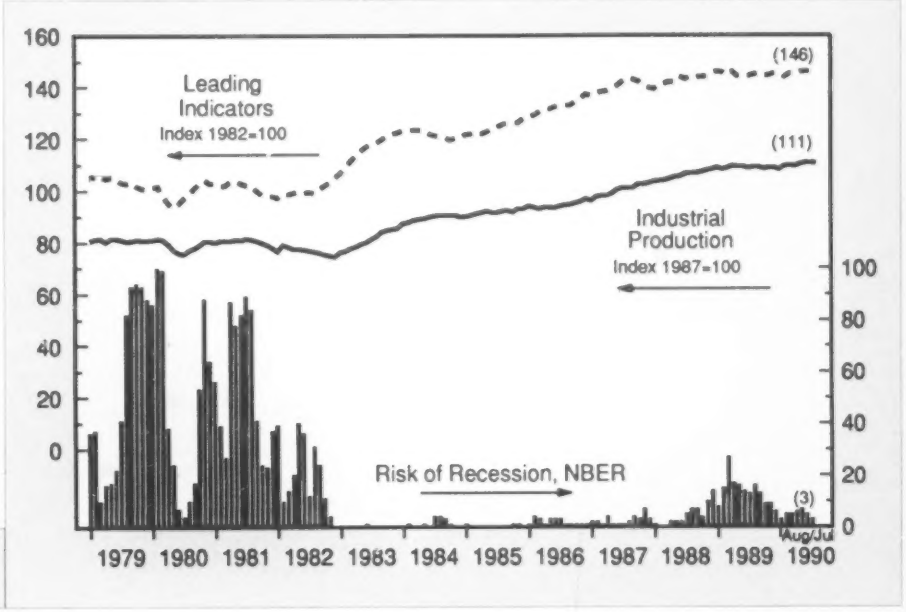
Where…can defense contractors turn?…Areas frequently mentioned that could benefit from application of defense technology include advanced urban mass transit systems, improved air and space travel, improved communications and weather forecasting, and more reliable air and highway traffic control systems.

Excerpted from *Business Week*, July 18, 1964.

Conference Board Stat File

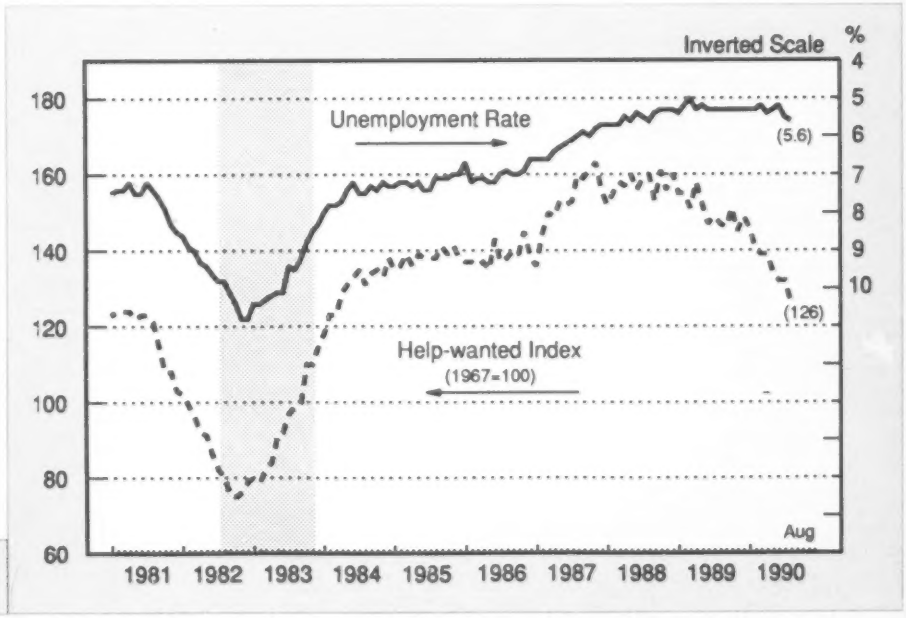
The data in our Stat File provide confirmation that the economy is sluggish, but are inconclusive on the widely heard idea that a recession lies immediately ahead. Two series do point that way, consumer expectations and help-wanted advertising. But others do not, including the leading indicators, the diffusion indexes, and especially the NBER risk-of-recession calculation. In our view, however, the chances of recesssion have increased to something close to even money, but our guess is that economic activity will bump along indecisively without quite falling into a cyclical downswing. Whatever happens, the economy seems sure to be soft enough that the media will be talking recession for some time ahead. *(Note: Data for Conference Board series in this section are available upon request from Ken Goldstein at 212-339-0331.)*

Early Warning Indicators



Flat economy. Recession risk low.

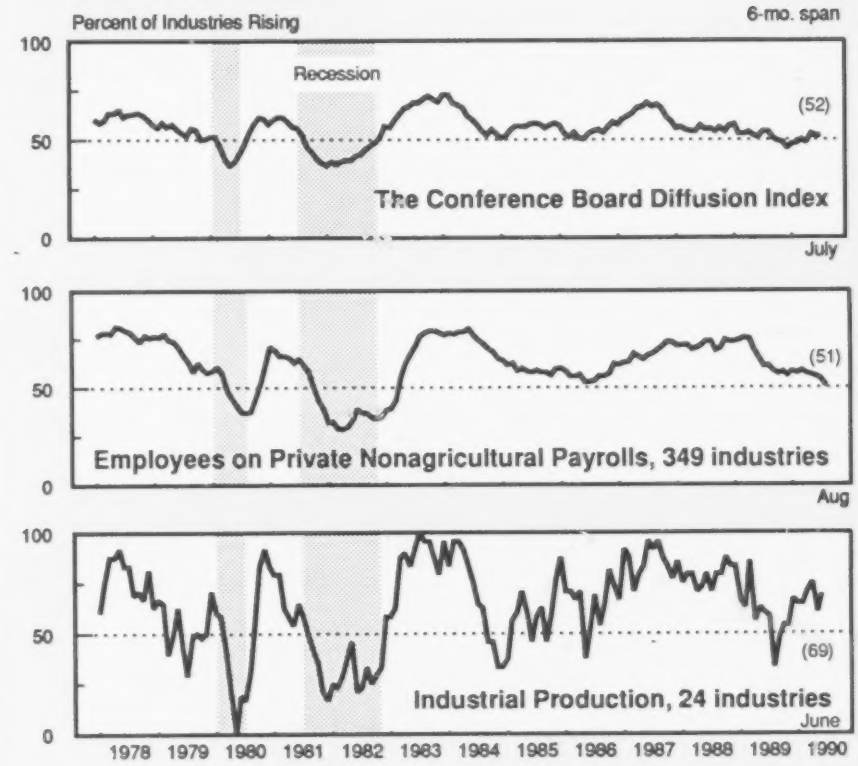
Help-wanted Advertising and Unemployment



Labor demand falling.

Conference Board Stat File

Indexes of Economic Momentum

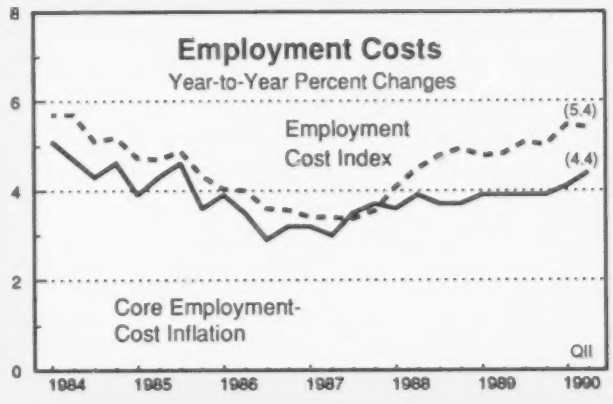


Momentum indicators in neutral.

Both prices and wages showing acceleration.

Inflation Fundamentals

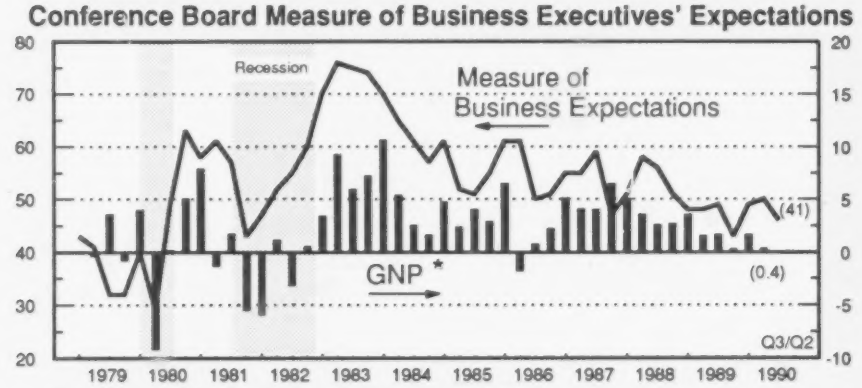
Core inflation = CPI excluding food at home and energy



Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e.,excluding the benefits that are part of the ECI)

Conference Board Stat File

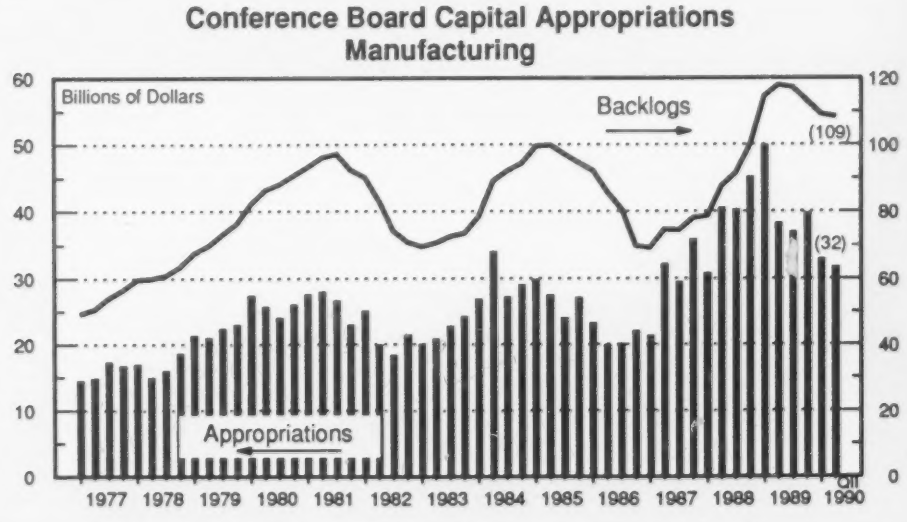
Confidence



* Quarterly percent changes in GNP at annual rates

Consumer confidence shaken.

Investment Intentions



Manufacturers' expansion plans losing energy.

Inside the Crystal Ball

		UCLA	MERRILL L.	DUPONT	GEORGIA ST.	CONF. BOARD	L.H. MEYER	DRI	WEFA		
Date of Forecast		Sept.	Sept.	Sept.	Sept.	Sept.	Sept.	Aug	Sept.		
Gross National Product											
(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)											
		%	%	%	%	%	%	%	%		
Actual	1990 1Q	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1Q 1990	Actual
	2Q	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	2Q	
Forecast	3Q	0.4	0.8	1.3	0.3	1.6	1.4	0.2	0.7	3Q	Forecast
	4Q	-2.4	0.2	0.0	-1.5	1.1	-2.1	-0.1	-0.8	4Q	
	1991 1Q	-3.2	0.7	-0.5	-0.5	2.0	-1.5	1.0	0.8	1Q 1991	
	2Q	1.8	1.5	0.6	-0.7	1.5	0.5	1.8	1.4	2Q	
	3Q	7.4	2.5	1.1	0.8	1.8	2.0	2.9	1.6	3Q	
	4Q	6.0	2.6	1.6	3.0	2.0	3.1	2.0	1.6	4Q	
	1992 1Q	3.8		4.0		3.5	2.7	2.6	2.3	1Q 1992	
	2Q	2.7		4.0		2.5	3.0	2.5	2.0	2Q	
	3Q									3Q	
Inflation (GNP Deflator)											
(Percent change from same quarter one year earlier)											
Actual	1989 4Q	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	1989 4Q	Actual
Forecast	1990 4Q	4.4	5.1	4.9	5.4	4.9	4.9	3.9	4.4	1990 4Q	Forecast
	1991 4Q	3.8	4.1	4.4	3.9	4.8	3.7	4.2	4.3	1991 4Q	
Unemployment Rate											
(Percent, quarterly)											
Actual	1990 1Q	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	1Q 1990	Actual
	2Q	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	2Q	
Forecast	3Q	5.6	5.5	5.5	5.6	5.6	5.5	5.6	5.5	3Q	Forecast
	4Q	6.1	5.8	5.7	5.9	5.6	5.9	5.9	5.9	4Q	
	1991 1Q	6.8	6.0	5.9	6.0	5.8	6.3	6.1	6.2	1Q 1991	
	2Q	7.1	6.1	6.0	6.3	5.8	6.5	6.2	6.3	2Q	
	3Q	6.9	6.0	6.0	6.4	5.8	6.7	6.2	6.3	3Q	
	4Q	6.5	5.9	6.0	6.0	5.8	6.7	6.2	6.3	4Q	
	1992 1Q	6.2		5.9		5.6	6.7	6.1	6.3	1Q 1992	
	2Q	6.0		5.8		5.5	6.6	6.1	6.3	2Q	
	3Q	5.8		5.7		5.5			6.2	3Q	

The Conference Board
845 Third Avenue
New York, N.Y. 10022

Second Class
Postage paid at New York, NY
and at
additional mailing offices